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Consumer Corner

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Attorneys' Fees and Chapter Choice

Exploring "No Money Down" Chapter 13 Bankruptcy



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One of the most important choices that individuals considering bankruptcy face is whether to file for chapter 7 or 13. This single decision affects how long people will spend in bankruptcy, the probability that they will receive debt forgiveness and what property they will retain. Chapter choice also controls how much bankruptcy attorneys charge their clients, and when consumers must pay their attorneys' fees. Attorneys charge about \$1,200 to file a chapter 7, which they require their clients to pay up front. Chapter 13 usually comes with attorneys' fees of about \$3,200, which can be paid over time in the chapter 13 plan.¹

What are people to do if they need to file for bankruptcy now but do not have money available to pay attorneys' fees up front? For some people, postponing bankruptcy for even a short time is not an option. Their financial crisis is immediate, with threats of wage garnishment, vehicle repossession or a foreclosure sale. How can attorneys respond to cash-strapped people who want to file for bankruptcy immediately?

Frequently, the answer is "no money down" bankruptcy. The authors coined this term to describe the increasingly prevalent practice of a consumer paying *nothing* in attorneys' fees before filing chapter 13. In a forthcoming article in the *Southern California Law Review*, the authors use new data from the ongoing Consumer Bankruptcy Project (CBP) to explore the "no money down" bankruptcy.² This article summarizes that article and discusses the law that influenced the creation of "no money down" chapter 13s, which households are more likely to file with "no money down," and why this type of chapter 13 case might be less than optimal for the consumer bankruptcy system. It also overviews the reforms that the authors suggest to correct some of the inefficiencies resulting from the circumstances that create "no money down" bankruptcy.

Background on the CBP

The CBP is a multi-researcher, long-term project designed to understand who files for bankruptcy, why people file for bankruptcy and

the consequences of their filings. Past iterations occurred in 1981, 1991, 2001 and 2007 and were episodic.³ In 2013, the authors relaunched the CBP as an ongoing data-collection project, which is hereinafter referred to as the "current CBP."

Both the 2007 CBP and the current CBP use a national random sample of individuals who filed either chapter 7 or 13. Both studies draw data from a debtor's bankruptcy court records and written questionnaires mailed to the debtors to collect demographic information and details on the debtor's circumstances; the authors rely on data from the 2007 CBP and the current CBP. From the 2007 CBP data, the authors use court records and questionnaire data from the 2,437 debtors who returned questionnaires.⁴ From the current CBP, the authors use the 670 questionnaires returned by the debtors as well as all court record data from all 2,400 cases in the 2013-15 sample.⁵

Lamie and the Need for a "No Money Down" Chapter 13 Option

The legal origins of "no money down" chapter 13 lie in the U.S. Supreme Court's decision in *Lamie v. United States Trustee*.⁶ Although *Lamie* featured a complex fact pattern involving conversion from chapter 11 to chapter 7, the decision's significance is that any attorneys' fees a chapter 7 debtor owes prior to filing are considered pre-petition unsecured debts subject to being discharged with little to no payment.⁷ Chapter 7 debtors' attorneys risk going unpaid if their clients do not give them the full amount of attorneys' fees before bankruptcy. As a result, attorneys require debtors to pay all fees before filing chapter 7 cases.

In chapter 13, however, the Bankruptcy Code specifically allows attorneys' fees to be paid during the years of repayment.⁸ This allows attorneys to offer struggling debtors access to bankruptcy immediately by filing for chapter 13 without paying all of the attorneys' fees up front. For some

3 Three of the article's authors have been involved with the CBP since 2001. In addition, Prof. Lawless serves as reporter of ABI's Commission on Consumer Bankruptcy (for more information on its mission, visit consumercommission.abi.org).

4 For a detailed methodology of the 2007 CBP, see Katherine Porter, "Appendix: Methodology of the 2007 Consumer Bankruptcy Project," *Broke: How Debt Bankrupts the Middle Class*, p. 235 (Katherine Porter ed., 2012).

5 For a detailed methodology of the current CBP, see *supra* n.2 at Part III.A.

6 540 U.S. 526 (2004).

7 *Id.* at 533-34.

8 11 U.S.C. § 330.

1 These figures are medians based on national data from the Consumer Bankruptcy Project, which is described herein. All dollar figures are inflation-adjusted to constant 2015 dollars using the Consumer Price Index, U.S. Department of Labor, available at bls.gov/cpi.

2 Pamela Foohey, Robert M. Lawless, Katherine M. Porter and Deborah Thorne, "No Money Down" Bankruptcy, 90 S. Cal. L. Rev. ____ (forthcoming 2017), available at ssrn.com/abstract=2925899.

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debtors, filing for bankruptcy without any up-front attorneys' fees might be critical to stopping wage garnishments, repossessions and foreclosures. For other debtors, the ability to file now and pay later may seem like a blessing; their attorney is proposing to lend them the money that is necessary in order to escape the torture of the overwhelming debts with which they have struggled for years. To investigate how debtors pay for chapter 13, the authors distinguish "no money down" chapter 13 (debtors pay nothing in attorneys' fees before filing) from "traditional" chapter 13 (debtors pay at least some of the attorneys' fees before filing), including those cases in which debtors pay as little as \$1 in attorneys' fees before filing.

Who Files with "No Money Down"?

The CBP data shows that "no money down" chapter 13 is a nationwide and increasingly prevalent phenomenon. The vast majority (more than 90 percent) of debtors who file for bankruptcy hire an attorney. Of the debtors who hired an attorney and filed between 2013 and 2015, 14 percent filed a chapter 13 with "no money down," a 25 percent increase from 2007. Not only are more people filing "no money down" chapter 13 cases, between 2007 and the current CBP more people paid a smaller percentage of attorneys' fees before bankruptcy. The CBP data also shows a marked shift toward paying less, and often nothing, in attorneys' fees prior to filing for chapter 13.⁹

These "no money down" people in bankruptcy are a distinct subset of debtors. The CBP data shows that their financial profiles are more similar to people who file for chapter 7 than to those who file traditional chapter 13 cases. In both the 2007 CBP and current CBP, "no money down" debtors had assets worth far less, were less likely to be homeowners, and owed their creditors less overall as compared to people filing traditional chapter 13 cases. "No money down" chapter 13 debtors also closely resembled chapter 7 debtors on these and other key financial measures.¹⁰

The authors further identified two other differences between "no money down" and other debtors; neither difference relates to the benefits of chapter 13. First, the judicial district of bankruptcy is correlated with a "no money down" filing. The chapter 13 versus chapter 7 filing rate varies considerably by judicial district.¹¹ Debtors from high chapter 13 districts are (by definition) more likely to file for chapter 13. However, the authors found that high chapter 13 districts are also high "no money down" districts. The prevalence of chapter 13 cases seems to prompt a higher likelihood of "no money down" cases.¹²

Second, a debtor's race is strongly related to the likelihood of a "no money down" bankruptcy. African-American households constitute almost half (49 percent) of

"no money down" bankruptcies. Yet only about a quarter (24 percent) of households in our samples were African-American. In comparative terms, approximately one-quarter of African-American households filed "no money down," as compared to less than 8 percent of all other households, which had similar patterns of filing types.¹³ African-Americans are heavily overrepresented in "no money down" bankruptcies.

These findings build on research that has found that African-Americans are more likely to file for chapter 13 than similar non-African-American debtors.¹⁴ This new data and analysis shows that African-American households are also more likely to pay nothing toward attorneys' fees before filing for chapter 13.

Although district and race could just happen to correlate with other factors that make a debtor less likely to pay attorneys' fees before filing, the authors were unable to eliminate the effect. The authors ran regression analyses that controlled for possible confounding variables likely to affect the incidence of "no money down" chapter 13s, including financial characteristics, a debtor's prebankruptcy efforts to address their debts and demographic characteristics.¹⁵ The district and race effects on "no money down" bankruptcies remain, even after controlling for other factors.¹⁶ In fact, these results suggest that "no money down" chapter 13 may explain much of the racial disparity in chapter 13 filing rates.¹⁷

The Meaning of "No Money Down" Chapter 13s for the Bankruptcy System

Because people who file "no money down" chapter 13 cases enter bankruptcy with financial profiles more similar to chapter 7 debtors than other chapter 13 debtors, the authors also assessed how these debtors fared. One of bankruptcy's most significant benefits is debt forgiveness.

Looking at the 2007 CBP data,¹⁸ as summarized in the chart, almost all of the chapter 7 cases resulted in a discharge, as compared to a bit less than half of the "no money down" chapter 13 cases and about half of traditional chapter 13 cases.¹⁹ The dismissal rate for "no money down" chapter 13 cases is 18 *times* higher than chapter 7 cases. As compared to the chapter 7 filers with whom they share many characteristics, people who filed with "no money down" paid more and received less in bankruptcy.

In many cases, the "no money down" option might make perfect sense, despite debtors owing approximately \$2,000 more in attorneys' fees and facing a high probability that the case will not end in discharge. Likewise, there are

⁹ *Id.*

¹⁴ See generally Jean Braucher, Dov Cohen and Robert M. Lawless, "Race, Attorney Influence and Bankruptcy Chapter Choice," 9 *J. Empirical L. Studies* 393 (2012).

¹⁵ For list and description of measures used, see *supra* n.2 at Part III.C.2.a.

¹⁶ *Id.* at Part III.C.2.b and c.

¹⁷ *Id.*

¹⁸ The authors analyzed 2007 CBP data because at the time of analysis, most chapter 13 cases filed in 2013, 2014 and 2015 remained pending.

¹⁹ *Supra* n.2 at Part III.D.

⁹ *Supra* n.2 at Part III.B.

¹⁰ *Id.* at Part III.C.1.

¹¹ *Id.* at n.44 at Part II.B.

¹² *Id.* at Part III.C.2.

logical reasons for bankruptcy attorneys to offer this option to cash-strapped debtors, such as to stop wage garnishments and foreclosures.²⁰

The authors think the increasingly prevalent phenomenon of “no money down” chapter 13 cases is concerning. To the extent that a “no money down” option might make sense for particular debtors, there is no reason to think that these debtors should be concentrated in a particular location or racial group. “No money down” bankruptcy fits within a pattern of lower-income individuals and African-Americans paying more for goods and services and, on average, receiving less.²¹ The bankruptcy system is one of the largest social safety institutions in America, and access to that system should be the same for all.

Making “No Money Down” Chapter 13s a More Robust Option

Removing the timing aspect of paying attorneys’ fees from the chapter-choice decision is the best reform to improve equal access to bankruptcy, regardless of a debtor’s immediate ability to pay. The most obvious solution is to allow debtors to pay attorneys’ fees in installments during their chapter 7 cases,²² thereby aligning how debtors may pay their attorneys in both chapters. However, the chapter 13 versus chapter 7 filing rate varies considerably by judi-

cial district and may present barriers to offering “no money down” chapter 7 once it is an option. The authors also suggest amendments to standing orders that set “no look” fees for chapter 13 cases and provide guidance about the payment of attorneys’ fees through chapter 13 plans. These suggestions focus on assisting judges and trustees in identifying debtors who have filed for chapter 13 but may benefit more from chapter 7.²³

Removing the timing aspect of paying attorneys’ fees from the chapter-choice decision is the best reform to improve equal access to bankruptcy.

The ultimate goal of these suggestions is not to abolish “no money down” chapter 13s, but to allow all debtors to weigh the benefits and costs of filing chapter 7 or 13 without having to consider how they will pay the attorneys’ fees. For now, the future of “no money down” chapter 13 is in the hands of bankruptcy attorneys, judges and trustees, as they are best able to assess a debtor’s use of “no money down” chapter 13 and ensure that all people have an equal opportunity to receive bankruptcy’s benefits. **abi**

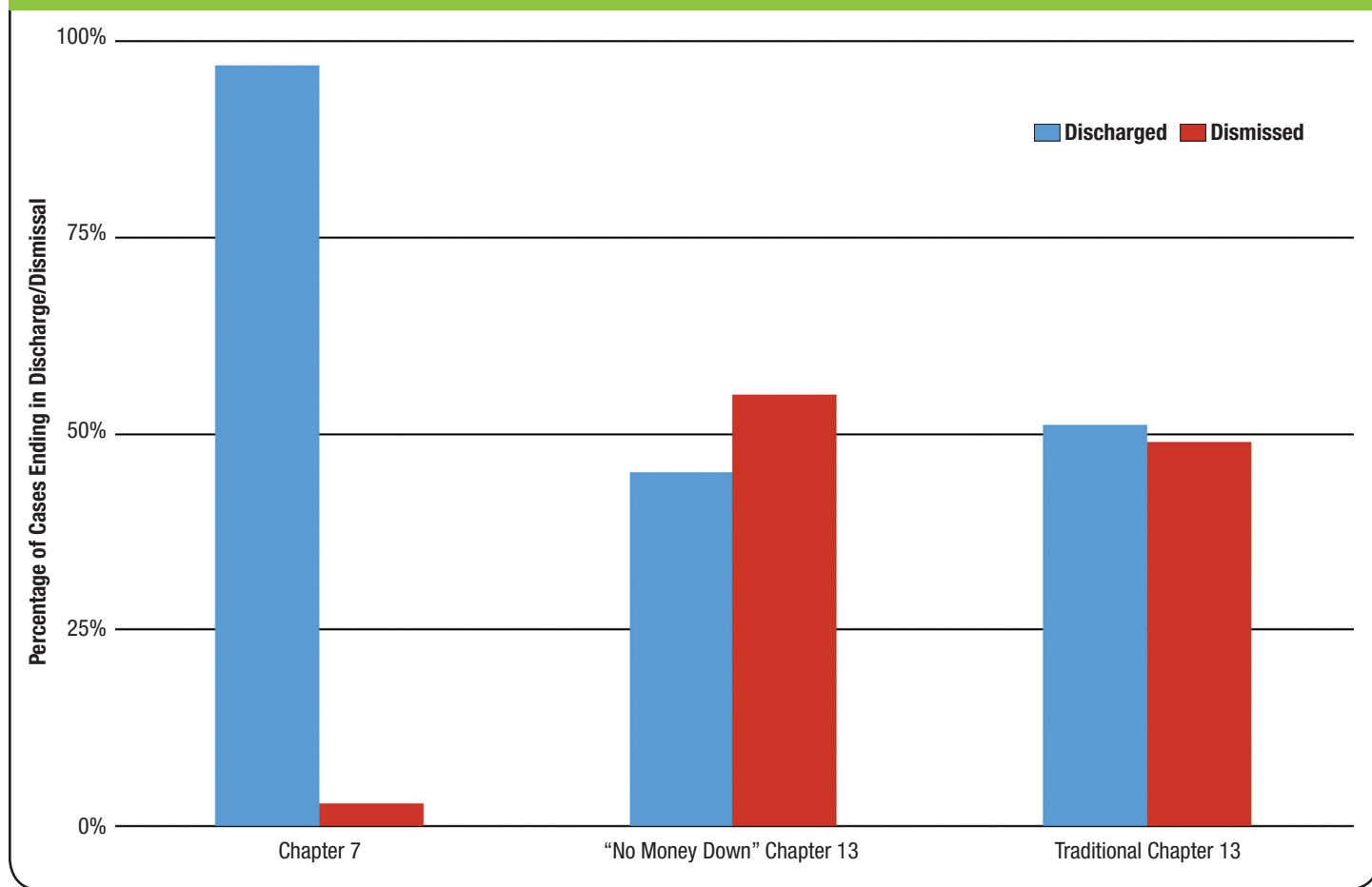
20 For a discussion of these reasons, see *id.* at Part III.E.

21 See *id.* at Part IV.A.

22 This proposal also requires changes to the dischargeability of attorneys’ fees that are incurred pre-petition.

23 For a discussion of these suggestions, see *supra* n.2 at Part IV.B. The suggestions in the full article focus on judges and trustees, and the article explains why the authors are focusing their suggestions on those two actors in the bankruptcy system.

Case Outcomes by Chapter (2007 CBP)



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